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Nov. 10, 2003

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November xx, 2003

Memphis Light, Gas & Water Division  
220 South Main Street  
Memphis, Tennessee 38103-3917  
and  
Memphis Networx, LLC  
7620 Appling Center Drive, Suite 101  
Memphis, Tennessee 38133

This will confirm our engagement by Memphis Light, Gas & Water Division (MLGW or the "Company") and Memphis Networx, LLC to perform agreed-upon procedures as set forth in Attachment B, which were agreed to by the Tennessee Regulatory Authority (TRA) and management of MLGW and Memphis Networx, solely to assist you in evaluating compliance with the TRA order dated August 9, 2001, as amended, during the period August 9, 2001 through December 31, 2002.

Should conditions not now anticipated preclude us from completing our engagement and issuing an agreed-upon procedures report as contemplated by the preceding paragraph, we will advise you and representatives of the TRA promptly and take such action as we consider appropriate.

Our report will be restricted to MLGW, Memphis Networx, and the TRA since only these parties have agreed upon the procedures to be performed and taken responsibility for the sufficiency of those procedures. In addition, our report will include all findings from the application of the agreed-upon procedures.

***Responsibilities and Limitations***

We will conduct our agreed-upon procedures engagement in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures performed either for the purpose for which this report has been requested or for any other purpose.

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Memphis Networkx, LLC

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Any modifications to the procedures expected to be performed will be communicated to the specified parties for their agreement.

We also may communicate other opportunities we observe for economies in, or improved controls over, the Company's operations.

***Specified Parties' Responsibilities and Representations***

MLGW, Memphis Networkx, and the TRA have reviewed the attached procedures that are expected to be performed and have agreed to the sufficiency of those procedures for their purpose.

MLGW, Memphis Networkx, and the TRA are solely responsible for the sufficiency of the procedures performed.

Compliance with the requirements applicable to its activities is the responsibility of the management of the Company, which is also responsible for identification of applicable compliance requirements, for establishing and maintaining internal control to provide reasonable assurance of compliance with those requirements, and for evaluating and monitoring the Company's compliance. Management of the Company is also responsible for specifying reports that satisfy legal, regulatory, or contractual requirements.

***Fees and Billings***

Our fee for our agreed-upon procedures engagement will be billed at 80% of our standard billing rates, plus expenses. We will submit our invoices monthly to Memphis Networkx, and payment of them will be made upon receipt. Upon execution of this engagement letter and prior to beginning work by Ernst & Young, Memphis Networkx will provide Ernst & Young a \$30,000 retainer fee.

Expenses such as computer hardware and software, access to the firm's knowledge and technology resources, long distance telephone and telecommunications charges, general photocopying, delivery, postage, clerical assistance, and other administrative expenses are based on a percentage (currently 11.5 percent) of our fees for professional services. Certain specialized items such as production of client financial statements and other more complex client documents may be billed separately on a time and materials basis. Expenses such as travel, meals, and accommodations will be charged as incurred. Please note that we may receive volume-based rebates from certain vendors (e.g., credit card companies) that are used to reduce overhead charges that would otherwise be passed on to our clients.

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Memphis Networx, LLC

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Our estimated schedule of performance is based upon, among other things, our preliminary review of the Company's records and the representations Company personnel have made to us and are dependent upon the Company's personnel providing assistance as set forth in Attachment B. Should our assumptions with respect to these matters be incorrect or should the condition of the records, degree of cooperation, or other matters beyond our reasonable control require additional commitments by us beyond those upon which our estimated fees are based, we may adjust our planned completion dates.

In the event we are requested or authorized by the Company or are required by government regulation, subpoena, or other legal process to produce our documents or our personnel as witnesses with respect to our engagement for the Company, the Company will, so long as we are not a party to the proceeding in which the information is sought, reimburse us for our professional time and expenses, as well as the fees and expenses of our counsel, incurred in responding to such requests.

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***Other Matters***

Any controversy or claim arising out of or relating to services covered by this letter or hereafter provided by us for the Company or at its request (including any such matter involving any parent, subsidiary, affiliate, successor in interest, or agent of the Company or of Ernst & Young LLP, or involving any person or entity for whose benefit the services in question are or were provided), shall be submitted first to voluntary mediation, and if mediation is not successful, then to binding arbitration, in accordance with the dispute resolution procedures set forth in Attachment A to this letter. Judgment on any arbitration award may be entered in any court having jurisdiction.

If any portion of this letter is held to be void, invalid, or otherwise unenforceable, in whole or part, the remaining portions of this letter shall remain in effect.

If these arrangements are acceptable, please sign one copy of this letter and return it to us.

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Memphis Networkx, LLC

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We very much appreciate the opportunity to perform this engagement for MLGW and Memphis Newtorx and would be pleased to furnish any additional information you may request.

Yours very truly,

Ernst & Young LLP

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Acknowledged by:

**Memphis Light, Gas & Water Division**

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By:

Title:

Date:

**Memphis Networkx, LLC**

By:

Title:

Date:

**Tennessee Regulatory Authority**

By:

Title:

Memphis Light, Gas & Water Division  
Memphis Networx, LLC

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Date:

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## Attachment A

### Dispute Resolution Procedures

The following procedures shall be used to resolve any controversy or claim ("dispute") as provided in our engagement letter of November xx, 2003. If any of these provisions are determined to be invalid or unenforceable, the remaining provisions shall remain in effect and binding on the parties to the fullest extent permitted by law.

#### *Mediation*

A dispute shall be submitted to mediation by written notice to the other party or parties. The mediator shall be selected by agreement of the parties. If the parties cannot agree on a mediator, a mediator shall be designated by the CPR Institute for Dispute Resolution at the request of a party. Any mediator so designated must be acceptable to all parties.

The mediation shall be conducted as specified by the mediator and agreed upon by the parties. The parties agree to discuss their differences in good faith and to attempt, with facilitation by the mediator, to reach an amicable resolution of the dispute. The mediation shall be treated as a settlement discussion and therefore shall be confidential. The mediator may not testify for either party in any later proceeding relating to the dispute. No recording or transcript shall be made of the mediation proceedings.

Each party shall bear its own costs in the mediation. The fees and expenses of the mediator shall be shared equally by the parties.

#### *Arbitration*

If a dispute has not been resolved within 90 days after the written notice beginning the mediation process (or a longer period, if the parties agree to extend the mediation), the mediation shall terminate and the dispute shall be settled by arbitration. The arbitration will be conducted in accordance with the procedures in this document and the Rules for Non-Administered Arbitration of the CPR Institute for Dispute Resolution ("Rules") as in effect on the date of the engagement letter, or such other rules and procedures as the parties may designate by mutual agreement. In the event of a conflict, the provisions of this document will control.

The arbitration will be conducted before a panel of three arbitrators, two of whom are to be designated by the parties from the CPR Panels of Distinguished Neutrals using the screened selection process provided in the Rules. Any issue concerning the extent to which any dispute is subject to arbitration, or concerning the applicability, interpretation, or enforceability of these procedures, including any contention that all or part of these procedures are invalid or unenforceable, shall be governed by the Federal Arbitration Act and resolved by the arbitrators. No potential arbitrator shall be appointed unless he or she has agreed in writing to abide and be bound by these procedures.

The arbitration panel shall have no power to award non-monetary or equitable relief of any sort. It shall also have no power to award (a) damages inconsistent with any

**Attachment A**  
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applicable agreement between the parties or (b) punitive damages or any other damages not measured by the prevailing party's actual damages; and the parties expressly waive their right to obtain such damages in arbitration or in any other forum. In no event, even if any other portion of these provisions is held to be invalid or unenforceable, shall the arbitration panel have power to make an award or impose a remedy that could not be made or imposed by a court deciding the matter in the same jurisdiction.

Discovery shall be permitted in connection with the arbitration only to the extent, if any, expressly authorized by the arbitration panel upon a showing of substantial need by the party seeking discovery.

All aspects of the arbitration shall be treated as confidential. The parties and the arbitration panel may disclose the existence, content or results of the arbitration only as provided in the Rules. Before making any such disclosure, a party shall give written notice to all other parties and shall afford such parties a reasonable opportunity to protect their interests.

The result of the arbitration will be binding on the parties, and judgment on the arbitration award may be entered in any court having jurisdiction.

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Attachment B

## **INTRODUCTION**

On August 9, 2001, the Tennessee Regulatory Authority ("Authority" or "TRA") issued an order approving the Joint Petition of Memphis Light, Gas & Water Division ("MLGW") and Memphis Broadband, LLC for the creation of and operation of Memphis Networx, LLC ("Memphis Networx"). Further, the Authority granted the application of Memphis Networx, LLC for a Certificate of Public Convenience and Necessity.

Based upon the TRA order issued on August 9, 2001, appropriate professional standards and discussions with TRA, MLGW and Memphis Networx representatives, it has been agreed that the following procedures will be performed and an Agreed-Upon Procedures ("AUP") will be issued.

## **Client Assistance List**

The following information should be provided to the auditors at the beginning of on-site fieldwork. Copies should be provided for inclusion in work papers unless otherwise noted. The period subject to the AUP is August 9, 2001, to December 31, 2002; therefore, information requested is for the year ended December 31, 2002 and for the period August 9, 2001, to December 31, 2001.

- I. Financial, organizational and contractual information:
  - A. Financial statements for:
    1. MLGW, inclusive of the Telecommunications Division;
    2. The Telecommunications Division of MLGW;
    3. Memphis Networx.
  - B. Internal audit reports of MLGW for the period of August 2001 to December 31, 2002 that relate to the Telecommunications Division
  - C. Audited financial statements for MLGW for 2001 and 2002 with report of independent auditors.
  - D. Audited financial statements for Memphis Networx for 2001 and 2002 with report of independent auditors.
  - E. Chart of accounts and trial balance for the Telecommunications Division of MLGW;
  - F. Cost allocation manual pertaining to the Telecommunications Division
  - G. Operating Agreement between MLGW, Memphis Broadband, LLC and Memphis Networx
  - H. All written contracts entered into between MLGW and Memphis Networx; and a summary of any oral contracts or agreements between MLGW and Memphis Networx
  - I. All other written contracts and agreements, including loans, entered into between MLGW and its Telecommunications Division; and a summary of any oral contracts or agreements between MLGW and its Telecommunications Division
  - J. Listing of contracts between MLGW and third parties for pole attachment rates and underground installations. Have all contracts available.



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- K. Listing of employees of MLGW and Memphis Networkx.
- L. Copy of the annual report filed with the TRA by MLGW and Memphis Networkx for the period August 2001 through December 31, 2002
- M. A calculation of the effective interest rate on each loan from MLGW to the Telecommunications Division.

**COMPLIANCE REQUIREMENTS**

Note: Compliance requirements are outlined in the following State laws and Authority orders:

- A. Tenn. Code Ann. §§ 7-52-401 through 7-52-407 and statutes referenced therein
- B. Tennessee Regulatory Authority's August 9, 2001, Order approving Memphis Networkx franchise.

Applicable NARUC guidelines and FCC rules are as follows:

- A. National Association of Regulatory Utility Commissioner's "Cost Allocation and Affiliate Transactions Guidelines for the Energy Industry";
- B. Federal Communication Commission affiliate transaction rules, 47 Code of Federal Regulations § 32.27; and
- C. Federal Communication Commission cost allocation rules, 47 Code of Federal Regulations §§ 64.901 through 64.904.

Below is a listing of compliance requirements:

- I. MLGW and Memphis Networkx shall not have common employees.
- II. MLGW shall charge to Memphis Networkx the highest rate for pole attachments and underground installations as it charges third parties under comparable agreements required by Tenn. Code Ann. §7-52-405.
- III. Funds loaned to the Telecommunications Division by MLGW shall be loaned at a rate of interest not less the highest rate then earned by MLGW on invested electric plant funds.
- IV. MLGW shall not provide subsidies to Memphis Networkx as required by Tenn. Code Ann. §7-52-402.
- V. MLGW shall maintain records to comply with:
  - A. National Association of Regulatory Utility Commissioner's "Cost Allocation and Affiliate Transactions Guidelines for the Energy Industry";
  - B. Federal Communication Commission affiliate transaction rules, 47 Code of Federal Regulations § 32.27; and
  - C. Federal Communication Commission cost allocation rules, 47 Code of Federal

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Regulations §§ 64.901 though 64.904.

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**ENGAGEMENT PLAN**

I. Engagement period

The period subject to this work plan is August 2001 through December 31, 2002.

II. Conditions of Engagement

A. The independent auditor selected is:

John Skelton, Partner  
Ernst & Young, LLP  
2400 One Commerce Square  
Memphis Tennessee 38103  
Phone: (901) 577-6319  
Fax: (901) 577-6339  
Email: [john.skelton@ey.com](mailto:john.skelton@ey.com)

B. Members of the audit team shall have a sufficient understanding of the following:

1. Tenn. Code Ann. §§ 7-52-401 through 7-52-407 and statutes referenced therein;
2. Tennessee Regulatory Authority's August 9, 2001 Order approving Memphis Networx franchise;
3. National Association of Regulatory Utility Commissioner's "Cost Allocation and Affiliate Transactions Guidelines for the Energy Industry";
4. Federal Communication Commission affiliate transaction rules, 47 Code of Federal Regulations § 32.27; and  
Federal Communication Commission cost allocation rules, 47 Code of Federal Regulations §§ 64.901 through 64.904;
5. MLGW's cost allocation manual; and
6. Operating Agreement between MLGW, Memphis Broadband, LLC and Memphis Networx.

C. Independent auditor shall be independent as defined in the Statements on Standards for Attestation Engagements as set forth by the AICPA and in compliance with GAO independence standards.

D. In addition, to the extent the independent auditor determines procedures included in this plan cannot be performed; the independent auditor will notify the Authority. The independent auditor will inform the Authority if the independent auditor determines it is necessary to modify the agreed-upon procedures.

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- E. The independent auditor may use the services of a specialist for assistance in highly technical areas. The independent auditor and the specified parties shall explicitly agree to the involvement of any specialist to assist in the performance of the engagement. The specialist shall not be affiliated in any form with MLGW or Memphis Networkx.
- F. The independent auditor's use of internal auditors shall be limited to the provision of general assistance and the preparation of schedules and gathering of data for use in the engagement.

III. Representation Letters

- A. Obtain representation letters from the Chief Executive Officer and Chief Financial Officer of MLGW and Memphis Networkx addressing the following compliance items:
  - 1. acknowledgement of management responsibility for complying with specified requirements;
  - 2. acknowledgement of management responsibility for establishing and maintaining an effective internal control structure over compliance;
  - 3. statement that management has performed an internal evaluation of its compliance with the specified requirements;
  - 4. statement that management has disclosed or will disclose to the auditor all known noncompliance occurring up to the date of the report;
  - 5. statement that management has made available all documentation related to compliance with the specified requirements;
  - 6. statement that management has disclosed all written communications from regulatory agencies, internal auditors, external auditors, and other auditors, and any written formal or informal complaints to regulatory agencies from competitors, concerning possible noncompliance with the specified requirements, including communications received between the end of the period addressed in management's assertion and the date of the auditor's report;
  - 7. statements that Memphis Networkx operates independently of MLGW; that MLGW owns no facilities jointly with Memphis Networkx; MLGW provides no operations, installation, and maintenance functions over the facilities owned by Memphis Networkx, or leased by Memphis Networkx from unaffiliated entities; Memphis Networkx provides no operations, installation, and maintenance functions over MLGW's facilities;
  - 8. statement that Memphis Networkx has separate officers, directors, and employees from those of MLGW;
  - 9. statement that MLGW charged to Memphis Networkx the highest rate for pole attachments and underground installations as it charges third parties under comparable agreements required by Tenn. Code Ann. §7-52-405.
  - 10. statement that funds loaned to the Telecommunications Division by MLGW were

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loaned at a rate of interest not less the highest rate then earned by MLGW on invested electric plant funds.

11. statement that MLGW did not provide subsidies to Memphis Networkx as required by Tenn. Code Ann. §7-52-402.
  12. statement that MLGW maintained records to comply with National Association of Regulatory Utility Commissioner's "Cost Allocation and Affiliate Transactions Guidelines for the Energy Industry"; Federal Communication Commission affiliate transaction rules, 47 Code of Federal Regulations § 32.27; and Federal Communication Commission cost allocation rules, 47 Code of Federal Regulations §§ 64.901 through 64.904.
- B. Obtain representation letters related to financial issues signed by the Chief Financial Officer or the equivalent of MLGW and Memphis Networkx that include the following:
1. statement that Memphis Networkx maintains separate books, records, and accounts from those of MLGW and that such separate books, records, and accounts are maintained in accordance with Generally Accepted Accounting Principles ("GAAP");
  2. statement that Memphis Networkx has not obtained credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of MLGW;
  3. statement that management has identified to the auditor all assets transferred or sold since the last audit, and services rendered: (i) by MLGW to Memphis Networkx, and (ii) by Memphis Networkx to MLGW, and that these transactions have been accounted for in accordance with the TRA Order;
  4. statement that management has not changed any of MLGW's processes or procedures (as they relate to transactions with Memphis Networkx) and that these procedures and processes have continued to be implemented on a consistent basis since the execution of these agreed-upon procedures through the date of the report (on MLGW's representation letter only);
  5. statement summarizing events subsequent to the engagement period, but prior to the issuance of the report, that may affect compliance with any of the objectives described in this document.

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IV. Engagement Process

A. The work plan will be presented to the TRA representatives for review. The representatives will meet to discuss the overall plan and will agree upon the procedures to be performed.

V. Report Structure

The auditor shall present the results of performing the procedures in the form of an agreed-upon procedures report consistent with AICPA standards.

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**OBJECTIVES AND PROCEDURES**

**OBJECTIVE I.** Pursuant to Tenn. Code Ann. § 7-52-405, determine whether MLGW has charged an amount for pole attachments and underground installations to Memphis Networkx equal to the highest rate charged by MLGW to any other person or entity for comparable attachments.

**PROCEDURES**

1. Obtain a listing of all pole attachment and underground installations agreements/contracts (including the billing rates) that MLGW has in place with other persons or entities. Select a sample of ## contracts and agree the terms of the contract (rate charged for pole attachments, underground installations, and conduit rental, term, customer) to the summary listing. The sample is to be chosen on a random basis.
2. Based on the listing of pole attachment and underground installations agreements/contracts provided by MLGW, determine the highest rate for pole attachments and underground installations that MLGW charges comparable persons or entities for pole attachments and underground installations. Select a sample of ## contracts with Memphis Networkx for pole attachment and underground installations and compare the rates charged to the highest rate for pole attachments and underground installations that MLGW charges comparable persons or entities. The sample is to be chosen on a random basis.
3. Obtain a copy of the annual report filed with the TRA by MLGW and Memphis Networkx for the period August 2001 through December 2002. Agree the amount charged to Memphis Networkx by MLGW to the MLGW general ledger and to the amount stated in the annual report filed with the TRA.

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**OBJECTIVE II.** Pursuant to Tenn. Code Ann. § 7-52-403, determine whether the interest costs for funds lent to the Telecommunications Division by MLGW to acquire, construct, and provide working capital for the system, plant and equipment are allocated at a rate not less than the highest rate earned by MLGW on invested electric plant funds.

**PROCEDURES**

1. Obtain copies of all loan agreements between MLGW and the Telecommunications Division between August 2001 and December 2002.
2. Compare the loan, interest expense/income and accrued interest amounts recorded in the Electric Division general ledger to the Telecommunications Division general ledger.
3. Obtain the monthly calculation of the effective interest rate on each loan from MLGW to the Telecommunications Division. DRAFT
4. Recompute the effective interest rate on each loan made by MLGW to the Telecommunications Division.
5. Obtain from MLGW the monthly calculation of the rate MLGW earned on invested electric division plant funds during the loan period.
6. Compare rates of interest for loans to the Telecommunications Division with rates earned by MLGW on its invested electric division plant funds.



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**OBJECTIVE III.** Determine whether MLGW and Memphis Networkx have separate employees.

**PROCEDURES**

1. Obtain payroll ledgers, inclusive of employee names and social security/employee identification number, for MLGW and Memphis Networkx for the period August 2001 through December 2002.
2. On a random basis select a sample of ## Networkx employees to test for inclusion on MLGW's payroll ledger. Cross reference employee names and social security/employee identification numbers to test whether separate employees have been maintained.
3. Obtain from management a listing of anyone simultaneously employed by MLGW and Memphis Networkx.

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**OBJECTIVE IV. Determine whether costs of MLGW have been properly allocated to its Telecommunications Division.**

**PROCEDURES**

1. Obtain a copy of the annual report filed with the TRA by MLGW for the period August 2001 through December 2002.
2. Obtain a list of MLGW costs allocated to the Telecommunications Division and agree allocated amounts to the general ledger for the Telecommunications Division (allocated costs could include administrative and general, labor, legal, travel, consulting, and/or other).
3. For each identified allocated cost, compare the amount of costs allocated to the Telecommunications Division with the amount stated in the annual report filed with the TRA.
4. For each identified allocated cost, obtain from MLGW the calculations used in determining the amount of costs allocated to the Telecommunications Division. Recompute the calculations used by MLGW to allocate the costs to the Telecommunications Division.
5. For each identified allocated cost, determine whether the calculation for allocating costs is in accordance with MLGW's cost allocation manual.
6. Agree amounts used in the cost allocation calculation to MLGW's general ledger or other documentation from the accounting records of MLGW.

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**OBJECTIVE V.** Determine whether any other expenses of MLGW have been charged to its Telecommunications Division and, if so, determine whether such charges are in compliance with the cost allocation manual.

**PROCEDURES**

1. Obtain a listing of expenses charged directly to the Telecommunications Division general ledger.
2. Randomly select ## charges and agree each charge to the vendor invoice or other documentation of the charge.

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**OBJECTIVE VI.** Determine whether MLGW has billed Memphis Networx the appropriate tariff rates for electric, gas and water services provided to Memphis Networx.

**PROCEDURES**

1. Obtain copies of monthly bills rendered to Memphis Networx by MLGW for electric, gas and water services from August 2001 through December 2002.
2. Obtain from MLGW MLGW tariff rate schedule(s) applicable to Memphis Networx for electric, gas and water service. Recalculate the invoiced amounts.
3. Agree monthly amounts billed from MLGW for electric, gas and water service to the general ledger accounts of Memphis Networx.

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**OBJECTIVE VII. Determine whether the amounts billed by MLGW to Memphis Networkx for non-tariff services, specifically make-ready work & engineering, are appropriate.**

**PROCEDURES**

1. Obtain from MLGW a summary of all non-tariff services, specifically the type of work associated with the make-ready work and engineering, performed for Memphis Networkx by MLGW.
2. Obtain from MLGW all invoices/contracts, including underlying calculations, for all non-tariff services billed by MLGW to Memphis Networkx from August 2001 through December 2002.
3. Agree the amounts for all non-tariff services per the MLGW general ledger to the amounts stated in the annual report filed by MLGW with the TRA.
4. For a sample of ## charges for non-tariff services, perform the following:
  - a. Agree the invoiced amounts to calculations/work papers, which were prepared by MLGW to support the invoice.
  - b. Recalculate the amounts provided by MLGW.

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**OBJECTIVE VIII. Determine whether any revenues of MLGW have been allocated to its Telecommunications Division and, if so, determine the reasonableness of the allocation.**

**PROCEDURES**

1. Obtain from MLGW the approach and rationale used in determining the method for allocating revenues to the Telecommunications Division.
2. Agree the approach used for allocating these revenues to the approach set forth in MLGW's cost allocation manual.
3. Obtain the detailed calculations used in determining the amounts of these revenues allocated to the Telecommunications Division. Test the clerical accuracy of the calculations.

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**PROCEDURES FOR SUBSEQUENT EVENTS**

1. Inquire of management whether processes and procedures in place during the engagement period for ensuring compliance with statutory and Authority requirements have changed subsequent to the engagement period.
2. Obtain written representation from management as to whether any events have occurred subsequent to the engagement period, but prior to the issuance of the report, which may affect compliance with any of the objectives described herein.

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